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AGENDA ITEM 4

**TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION
COMMITTEE**

I. SUBJECT: State and Schools Employer Contribution Rates for
the Fiscal Year July 1, 2008 through June 30, 2009

II. PROGRAM: Actuarial & Employer Services

III. RECOMMENDATION:

That the Committee recommends to the full Board the adoption of the employer contribution rates for the State and Schools for the period July 1, 2008 to June 30, 2009 as set forth in the table on the following page.

IV. ANALYSIS:

State and Schools Employer Contribution Rates for 2008-2009

The Actuarial Office has completed the calculation of the employer contribution rates for the State and Schools for the fiscal year July 1, 2008 through June 30, 2009. A full actuarial report will be mailed under separate cover.

The table on the following page compares the fiscal year 2008-2009 contribution rates and the dollar amounts these rates are anticipated to generate with rates and contributions for the current fiscal year July 1, 2007 through June 30, 2008.

	2007-2008 Fiscal Year		2008-2009 Fiscal Year	
	Employer Contribution	Employer Rate	Employer Contribution	Employer Rate
State Miscellaneous Tier 1	\$1,413,213,985	16.633%	\$1,507,108,202	16.574%
State Miscellaneous Tier 2	76,240,651	16.565%	71,899,425	16.470%
State Industrial	66,099,489	17.345%	75,904,718	17.236%
State Safety	230,863,410	18.835%	281,762,944	18.411%
State Police Officers & Firefighters	781,314,695	25.552%	891,422,825	26.064%
California Highway Patrol	179,197,020	32.212%	197,083,258	32.149%
Total State	\$2,746,929,250		\$3,025,181,372	
Schools	919,528,538	9.306%	966,316,743	9.428%

Please refer to Attachment 1 for the development of the employer rate for each plan.

Reasons for Changes in Employer Contributions

Overall, the required contributions for the State plans have increased by \$278.3 million between fiscal year 2007-2008 and fiscal year 2008-2009 even though the contribution rates for most plans have gone down. The main reason for this increase is the growth in payroll for all State plans between the June 30, 2006 valuation and the June 30, 2007 valuation.

Overall, the total payroll for all State plans has increased by 9.6% over the prior year. This is substantially greater than the payroll growth assumption of 3.25% used in our actuarial valuation. The plan that saw the greatest increase in total payroll was the State Safety plan. The projected payroll for the State Safety plan for fiscal year 2008-2009 is almost 25% greater than the projected payroll for fiscal year 2007-2008. The table below compares the projected payroll for fiscal year 2007-2008 and fiscal year 2008-2009 for each State plan.

	Projected Payroll for 2007-2008	Projected Payroll for 2008-2009	Increase (%)
State Miscellaneous	\$8,956,470,395	\$9,529,563,494	6.4%
State Industrial	\$381,076,092	\$440,392,201	15.6%
State Safety	\$1,225,715,698	\$1,530,400,086	24.9%
State Police Officers & Firefighters	\$3,057,727,481	\$3,420,181,521	11.9%
California Highway Patrol	\$556,302,122	\$613,031,231	10.2%
Total State	\$14,177,291,788	\$15,533,568,534	9.6%

This growth in payroll was a combination of pay increases granted to existing employees as well as the growth in the number of active employees.

Pay increases granted to existing employees are a normal part of every employee's career. The actuarial valuations performed by CalPERS actuaries contain assumptions regarding salary increases. Actuarial losses occur when the salary increases granted to an individual are greater than anticipated by the actuarial assumptions. Similarly, actuarial gains occur when the salary increases are smaller than anticipated by the actuarial assumptions.

Between June 30, 2006 and June 30, 2007, the average salary increase granted to existing State active employees was greater than the salary increase anticipated by the actuarial assumptions. The tables below provide a comparison of the expected average salary increase and the actual average salary increase between June 30, 2006 and June 30, 2007 for each State plan for continuing active members i.e. members that were active both on June 30, 2006 and June 30, 2007.

	Average Salary on June 30, 2006	Expected Average Salary on June 30, 2007	Expected Salary Increase
State Miscellaneous	\$54,203	\$56,738	4.7%
State Industrial	\$43,213	\$45,559	5.4%
State Safety	\$57,490	\$59,932	4.2%
State Police Officers & Firefighters	\$67,152	\$70,701	5.3%
California Highway Patrol	\$76,287	\$79,455	4.2%

	Average Salary on June 30, 2006	Actual Average Salary on June 30, 2007	Actual Salary Increase
State Miscellaneous	\$54,203	\$58,146	7.3%
State Industrial	\$43,213	\$47,385	9.7%
State Safety	\$57,490	\$64,273	11.8%
State Police Officers & Firefighters	\$67,152	\$74,473	10.9%
California Highway Patrol	\$76,287	\$84,752	11.1%

As can be seen from the above tables, the average salary for continuing active members increased at a pace of 2.6% to 7.6% more than anticipated by the actuarial assumptions.

As mentioned above, the other reason for the growth in payroll was the growth in the active membership. The plan with the largest growth in its active membership was the State Safety plan. For this plan the active membership grew by 13.4%. Overall, the total active population for the State grew by 2.5%. The table on the following page shows a comparison of the number of active members for each plan between the June 30, 2006 valuation and the June 30, 2007 valuation.

	Number of Active Members on June 30, 2006	Number of Active Members on June 30, 2007	Increase (%)
State Miscellaneous	155,718	155,795	0.0%
State Industrial	8,220	8,859	7.8%
State Safety	20,149	22,852	13.4%
State Police Officers & Firefighters	42,477	44,864	5.6%
California Highway Patrol	6,824	6,926	1.5%
Total State	233,388	239,296	2.5%

Even though the main reason for the change in contribution was the growth in payroll, other events affected the overall contribution. The reasons for the changes in employer contributions for the State between fiscal year 2007-2008 and fiscal year 2008-2009 are as follows:

<u>Reason for Change</u>	<u>Change in Required Contribution (millions)</u>
Increase due to growth in payroll and normal progression of existing amortization bases	\$203.6
First installment of the 30 year amortization of the following actuarial gains and losses:	
• Greater than expected number of retirements in fiscal year 2006-2007	50.3
• Greater than expected investment return in fiscal year 2006-2007 and previously unrecognized investment gains	(62.8)
• Greater than expected contributions received in fiscal year 2006-2007 (higher than expected payroll)	(26.4)
• Greater than expected salary increases in fiscal year 2006-2007	105.9
• Other Gains and Losses	7.7
Total Change in Required Contributions	\$278.3

The required contributions for the Schools pool are also increasing. Overall, the required contributions for the Schools pool have increased by \$46.8 million between fiscal year 2007-2008 and fiscal year 2008-2009. The reasons for the changes in employer contributions for the Schools pool between fiscal year 2007-2008 and fiscal year 2008-2009 are as follows:

Schools Pool

<u>Reason for Change</u>	<u>Change in Required Contribution (millions)</u>
Increase due to growth in payroll and normal progression of existing amortization bases	\$33.1
First installment of the 30 year amortization of the following actuarial gains and losses:	
<ul style="list-style-type: none"> • Greater than expected investment return in fiscal year 2006-2007 and previously unrecognized investment gains 	(31.0)
<ul style="list-style-type: none"> • Greater than expected number of retirements in fiscal year 2006-2007 	43.7
<ul style="list-style-type: none"> • Greater than expected contributions received in fiscal year 2005-2006 (higher than expected payroll) 	(1.6)
<ul style="list-style-type: none"> • Other gains and losses 	2.6
Total Change in required contributions	\$46.8

Attachment 2 provides the total employer rate and contributions for each plan broken down into its major components as well as a reconciliation of the rate and contributions between the two fiscal years.

Recent Pattern in New Retirements

There continues to be unexpectedly higher numbers of retirement in fiscal year 2006-2007. The number of retirements continues to be at a higher level than anticipated by the actuarial assumptions, albeit at a rate approaching that anticipated by the assumptions. The number of State retirements between fiscal year 2005-2006 and fiscal year 2006-2007 has decreased by about 10%. In fiscal year 2006-2007, the number of State retirements was 13% greater than expected by the actuarial assumptions.

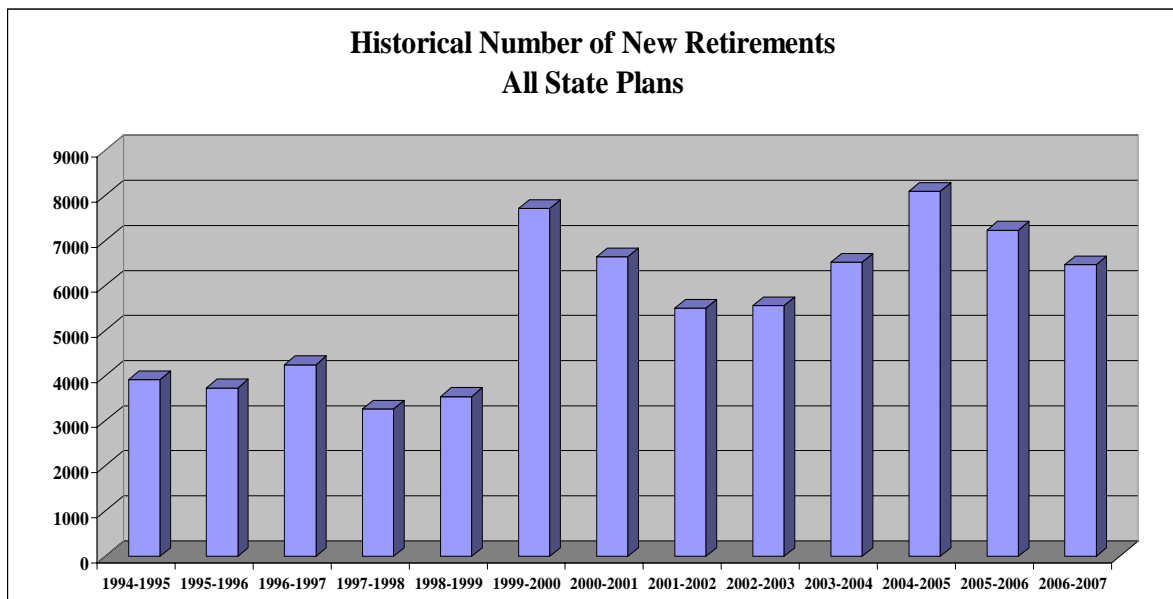
As can be seen in the chart below for the State plans, the years before the passage of SB 400 saw smaller numbers of retirement. In 2000 with the passage of SB 400, the number of retirements increased. This was expected when SB 400 costs were determined, as the costs were based on this increased number of retirements. In the following three years, the number of retirements decreased. CalPERS actuaries conducted an experience study which was based on the three years of experience that followed the implementation of SB 400. The study showed that the number of retirements after SB 400 was lower

Members of the Benefits and Program Administration Committee

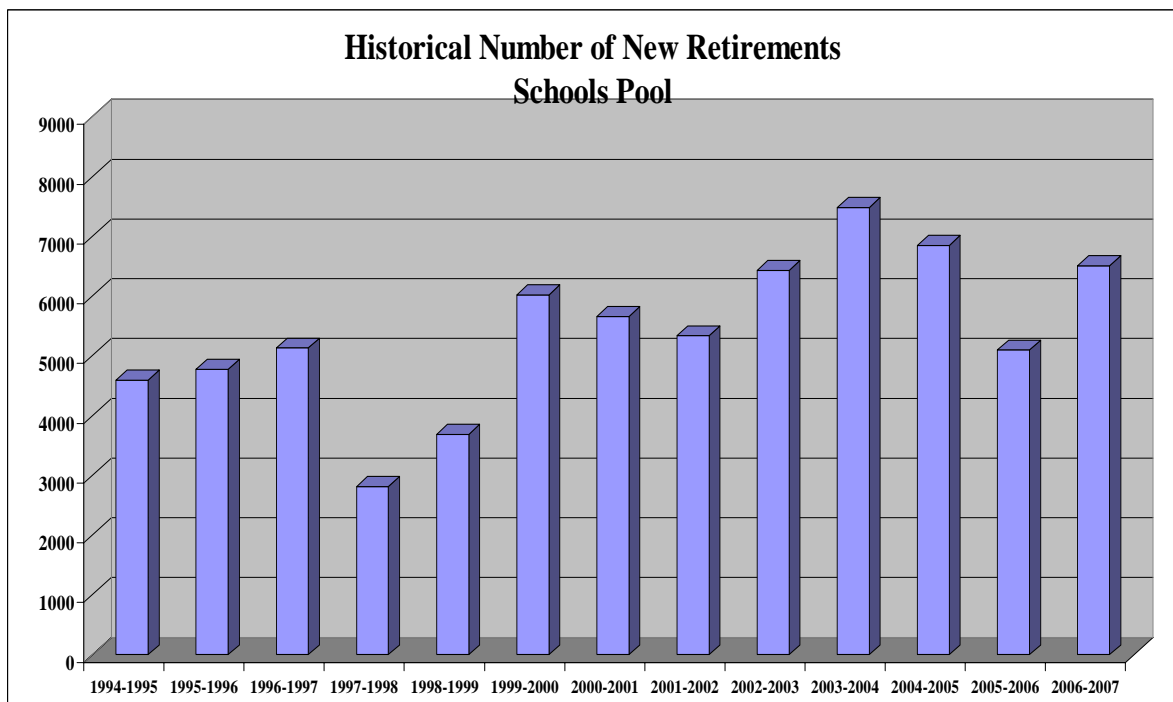
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than anticipated in the SB 400 cost analysis which led the actuarial office to lower the assumption about the anticipated number of retirements. Since the

completion of that study, we are seeing numbers of retirements higher than expected by the actuarial assumptions. However recent years have shown that the rate of retirements is approaching those predicted by the assumptions.



The chart below shows the historical number of new retirements for the Schools pool. As can be seen the number of retirements has also increased over the last few years.



While one may speculate about several factors which may account for this higher level of retirements, it is too soon to determine if this trend will continue in the future. Also, as noted above, 2006-2007 saw an increase in the number of retirements compared to 2005-2006. This current level of retirements is nearly 20% higher than our actuarial assumptions predict.

The Actuarial Office recently started working on an experience study. The current schedule is for this experience study to be completed in the spring of 2009. In that study we will be looking at demographic experience and deciding whether or not changes to existing actuarial assumptions are necessary and appropriate. That study will include the period covering this recent pattern in retirements. The main concern with reacting to sudden changes in behaviors and modifying assumptions is the fact that one would be changing actuarial assumptions and impacting employer rates each time a sudden change in behavior occurs, even if that change is temporary. We might need to wait until there is evidence that such a trend will continue in the long term before making significant changes to the actuarial assumptions.

History of the Expected Contribution Requirements

The following table shows the history the employer contributions set by CalPERS based on projected payroll for the State plans and the Schools pool going back to fiscal year 1996-1997.

Fiscal Year	Total State Contributions	Total School Contributions
1996-97	\$1,236,447,373	\$ 416,694,314
1997-98	1,223,327,746	317,571,853
1998-99	766,067,149	0
1999-00	159,460,097	0
2000-01	156,722,747	0
2001-02	677,244,769	0
2002-03	1,189,559,722	228,972,653
2003-04	2,212,518,481	869,501,830
2004-05	2,547,364,178	903,570,002
2005-06	2,428,720,628	826,672,339
2006-07	2,665,262,125	841,504,282
2007-08	2,746,929,250	919,528,538
2008-09	\$3,025,181,372	\$966,316,743

Funded Status

We are monitoring the funded status of the State plans and Schools pool using the market value of assets to ensure that the new rate stabilization methods do

not impair the security of benefits. The table below shows the funded status of the plans using the market value of assets. As can be seen, the funded status on a market value basis has continued to improve.

Funded Ratio of the Retirement Program (Based on the Market Value of Assets)					
	June 30, 2003	June 30, 2004	June 30, 2005	June 30, 2006	June 30, 2007
State Miscellaneous	76.3%	83.1%	86.2%	89.8%	98.6%
State Industrial	82.1%	88.3%	90.4%	95.0%	103.7%
State Safety	73.5%	81.3%	86.4%	89.2%	97.2%
State Police Officers & Firefighters	77.6%	83.0%	84.4%	86.0%	92.3%
California Highway Patrol	73.1%	78.7%	79.4%	81.5%	88.8%
Total State	76.4%	82.9%	85.5%	88.6%	96.6%
Schools	83.4%	91.4%	96.2%	98.7%	107.8%

Refer to Attachment 3 for the development of the accrued and unfunded liabilities as well as the funded ratio for each plan based on the market value of assets. The actuarial value of assets is only used for setting employer rates and keeping them as stable as possible.

Please refer to Attachment 4 for the development of the actuarial value of assets for each plan.

An Outlook for Fiscal Year 2009-2010

For the June 30, 2007 valuation, the asset smoothing method used to determine the actuarial value of assets resulted in an actuarial value of assets equal to about 86% of the market value for all plans. Using an actuarial value of assets that is less than market value means that not all prior investment gains have been fully recognized.

As a result, as long as the market value rate of return is greater than about -6.7% in fiscal year 2007-2008 then additional investment gains will be recognized in the June 30, 2008 valuation. In such cases, these investment gains will help lower the rates for fiscal year 2008-2009 if all other assumptions are realized.

V. STRATEGIC PLAN:

This item is not a specific product of the Strategic or Annual Plans but is part of the regular and ongoing workload of the Actuarial Office.

VI. RESULTS/COSTS:

See attachments.

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